

Fiscal Measures to Combact Ecological Externalities

Mrs Rakhi Mahajan¹, Dr. Umesh²

¹*Research Scholar: Deaprtment of Management Arni School of Business, Management and Commerce
Arni University, Kangra, H.P*

²*Pro Vice Chancellor, Arni University, kangra, H.P*

Abstract—Ecological externalities—environmental costs that are not reflected in market prices—represent a major challenge for sustainable economic development. Fiscal measures provide powerful policy instruments to internalize these externalities and guide economic behavior toward environmentally responsible outcomes. The study also explores the conditions under which fiscal policies generate optimal results, such as accurate valuation of environmental damages, transparent revenue recycling, and balanced regulatory frameworks. By assessing global policy experiences and theoretical foundations, the paper demonstrates that well-designed fiscal measures not only reduce negative ecological externalities but also stimulate innovation, promote energy efficiency, and support long-term economic sustainability.

Index Terms—Fiscal measures, economic development, policy

I. INTRODUCTION

The earth confronts an unparalleled and significant risk of extreme climate alterations, including elevated temperatures, rising sea levels, cyclones, and hurricanes, principally induced by environmental degradation resulting from global warming and ozone layer depletion (World Economic Forum, 2025). Environmental degradation involves the exhaustion of critical natural resources such as air, water, soil, flora, fauna, and other biotic and abiotic elements crucial to Earth's ecosystems (World Economic Forum, 2025). By 2025, global average temperatures have increased approximately 1.6°C above pre-industrial levels, signifying a decade of unprecedented heat exacerbated by anthropogenic activities, including fossil fuel combustion, which further contribute to greenhouse gas accumulation and climate change (Earth.Org, 2025). This warming precipitates catastrophic events globally, such as

extreme weather, biodiversity decline, and expedited melting of glaciers and ice sheets, resulting in sea-level rise that endangers coastal communities (United Nations, 2025). Notwithstanding global initiatives, greenhouse gas emissions persist at concerning levels, and the inability to effectively tackle climate action remains a significant long-term risk acknowledged by international organizations such as the World Economic Forum (World Economic Forum, 2025). Furthermore, ozone depletion exacerbates these issues by permitting detrimental ultraviolet light to impact ecosystems and climatic processes (European Environment Agency, 2024). The cumulative effect of these elements significantly endangers ecological equilibrium and human health, heightening the risks of food shortages, displacement, and worldwide socioeconomic vulnerabilities (Shavers, 2025). Prompt and significant decreases in emissions, along with synchronized environmental conservation efforts, are essential to alleviate these escalating dangers and safeguard Earth's life-support systems (United Nations, 2021; Committee on Climate Change, 2025; Charity Digital, 2025).

Measures Taken by International Agencies and Governments across the World to Mitigate Negative Eco Externalities

Environmental protection is crucial for securing a sustainable future and fostering long-term global development. Globally, governments have enacted various initiatives to protect the environment, such as environmental legislation, emissions trading schemes, emission standards, carbon accounting, energy taxes, environmental taxes, transport taxes, coal cesses, and carbon taxes (International Energy Agency, 2025; Lin & Li, 2011). These mechanisms seek to reduce greenhouse gas (GHG) emissions and promote carbon reduction to effectively address climate change and environmental deterioration. Coordinated

initiatives are essential for achieving international objectives, including the ambitions of the Paris Agreement and the United Nations Sustainable Development Goals (SDGs) centered on environmental sustainability (United Nations, 2025; World Economic Forum, 2025).

Enforcement of Laws

Governments globally have enacted legislation to alleviate the effects of negative externalities, with the enforcement of environmental regulations being a principal strategy since at least 1962 in nations such as Egypt. Society anticipates that governments will formulate, implement, and enforce legislation to mitigate the detrimental effects of negative externalities. In India, unethical or illegal environmental conduct is managed by criminal procedures and diverse environmental legislation, which can have a substantial effect when effectively enforced (Singh, 2009; Environmental Governance Institute, 2025). India has implemented several significant environmental protection statutes, including the Wildlife Protection Act (1972), Water (Prevention and Control of Pollution) Act (1974), Water Cess Act (1977), Forest Conservation Act (1980), Air (Prevention and Control of Pollution) Act (1981), Environment (Protection) Act (1986), Hazardous Waste Management Act (1989), Public Liability Insurance Act (1991), National Environment Tribunal Act (1995), Noise Pollution Rules (2000), Protection of Plant Varieties and Farmers' Rights Act (2001), Biological Diversity Act (2002), Scheduled Tribes and Other Traditional Forest Dwellers Act (2006), and the National Green Tribunal Act (2010) (Ministry of Environment, Forest and Climate Change [MoEFCC], 2024). Nonetheless, simple legislation is inadequate; rigorous implementation and enforcement pose significant obstacles due to issues such as public ignorance, resource scarcity, corruption, absence of accountability, and political meddling. Enhancing enforcement mechanisms and empowering regulatory agencies are essential for attaining environmental sustainability objectives (Environmental Governance Institute, 2025; Ministry of Law and Justice, 2025).

II. CAP AND TRADE SYSTEM

The cap-and-trade system is a market-oriented strategy implemented by governments globally to

regulate carbon emissions and alleviate environmental deterioration. The government establishes a ceiling on total greenhouse gas (GHG) emissions permitted from enterprises, aligned with national carbon reduction objectives, progressively decreasing the limit over time. Emission permits aligned with these limits are allocated to enterprises and can be exchanged freely, allowing companies who can cut emissions efficiently to sell surplus allowances to organizations with greater emissions. This mechanism promotes GHG reduction by establishing a market price for carbon emissions, so transforming CO₂ into a tradable commodity (Environmental Defense Fund, 2020; Investopedia, 2024). Although cap-and-trade effectively curtails air pollution, it fails to directly tackle water or soil contamination and does not mandate corporations to implement cleaner production methods—companies may merely acquire allowances to mitigate emissions, perpetuating detrimental practices (Chen et al., 2020; LSE Grantham Research Institute, 2024). To encourage emission reductions and elevated carbon pricing, authorities intend to establish rigorous caps that diminish supply; nevertheless, ascertaining suitable carbon prices continues to pose difficulties (Ellerman et al., 2016). Notwithstanding its constraints, cap-and-trade has proven effective in diminishing emissions in regions such as California and the European Union, showcasing environmental and economic advantages when properly structured and implemented (Schmalensee & Stavins, 2016).

Allan (2012) examines the effects of many human activities—such as production, consumption, home habits, and investment—on the environment, encompassing flora and fauna not directly involved in these processes. The author highlights considerable hazards to future generations stemming from resource overexploitation, potentially leading to diminished production and consumption capacity. These indirect repercussions, known as social cost externalities, present significant issues due to their difficulty in quantification under traditional accounting systems. The research underscores the imperative for governmental action through environmental taxation laws, highlighting that the disregard for externality costs detrimentally impacts market efficiency and hinders sustainable economic growth. Consequently, the research endorses the adoption of environmental

tax policies by governments to successfully mitigate social cost externalities.

Alvin et al. (2025) investigate the impact of corporate governance on social costs via production externalities employing a principal-agent model. They observe that an increase in monitoring costs prompts enterprises to implement high-powered incentives linked to output, so enhancing production but also elevating social costs, including workplace safety violations. The research utilises data from the coal sector, leveraging climate-induced divestment rules to demonstrate that diminished investor scrutiny results in firms amplifying production incentives, hence exacerbating social detriment. Companies with robust governance structures, such as independent boards or engaged shareholders, encounter a lesser rise in social costs. The findings underscore a significant trade-off in governance: aligning managers with shareholder objectives may unintentionally exacerbate negative externalities, indicating the necessity for governance frameworks that account for broader social implications. This study cautions that sustainable investing measures, such as divestment, may inadvertently elevate social costs in the absence of robust monitoring alternatives.

Nemetz (2013) examines the emerging disputes within industries compelled to implement sustainable practices. The paper assesses the swift advancement of corporate sustainability in response to significant environmental degradation and examines the disputed obligations of governments and corporations to mitigate negative externalities. The analysis concludes that while sustainable operations may open new economic opportunities for corporations, the financial outcomes remain uncertain. The study advocates for governments and enterprises to have a comprehensive grasp of sustainability to guide global economic reforms.

Russell (2014) rigorously analyzes existing obstacles in corporate sustainability reporting and accounting, especially with optimal resource distribution. The main aim was to clarify the tensions between sustainability and traditional accounting processes. The paper contends that financial statements that exclude social cost externalities fail to effectively depict corporate financial performance. The author presents an updated taxation framework that integrates externality expenses to promote fair reporting and sustainable company practices. The

results endorse comprehensive cost accounting and an adjusted taxation framework to facilitate sustainable reporting.

III. RESEARCH METHODOLOGY

The chapter delineates the methods employed to attain the research aims and objectives. **Methods:** The research design establishes the structural framework of your study, providing a clear explanation of the methods employed, the rationale for their selection, and the procedures adopted to justify the chosen approach for investigation, as well as outlining how you plan to navigate your research journey based on critically reviewed literature. It elucidates the rationale for sampling, data collection strategies, procedural approaches, and the criteria for selecting methodology employed in validating findings.

3.1. Research Questions

1. Is environmental taxation an appropriate fiscal measure to combat negative eco externalities?
2. How can the existing negative eco externalities be quantified to establish the basis for environmental taxation?

Objective of Study

1. To analyze the role and effectiveness of environmental taxation as a fiscal instrument for addressing negative eco-externalities in selected countries.
2. To quantify the magnitude of negative eco-externalities, thereby providing a solid empirical foundation for designing environmental taxes.

The study utilizes a stratified sampling method to select appropriate countries from the broader population. This stratification is based on the income classifications set by the World Bank. According to the World Bank, countries are divided into four income categories

1. Low-income economies
2. Lower-middle-income economies
3. Upper-middle-income economies
4. High-income economies

India is classified under the lower-middle-income economies category by the World Bank. Given the goal of developing an environmental tax model specifically tailored for India, it is crucial to draw insights from countries with economic and income levels comparable to those of India. Accordingly, the

sampling is performed on a population of 33 countries that align with India's income

classification as a lower-middle-income economy by the World Bank.

Table 1– list of Low-income countries with GDP per capita.

Country/Economy	GNI per Capita (US\$)	GDP (US\$ billions)	Real GDP Growth (%)
Afghanistan	450	22.8	2.5
Benin	1,010	17.2	5.8
Burkina Faso	950	19.4	6.2
Burundi	280	3.4	2.8
Central African Republic	480	2.4	3
Chad	700	15.3	2.7
Congo, Dem. Rep.	710	62.1	4
Eritrea	210	3.2	3.5
Gambia, The	780	3.1	5
Guinea	900	15.4	4.5
Guinea-Bissau	960	2.1	4.2
Korea, Dem. People	1,085	42.7	1.8
Liberia	790	4	3.2
Madagascar	550	16	3.8
Malawi	640	13.2	4.5
Mali	1,100	24.7	4.8
Mozambique	570	18	3.3
Niger	850	18.2	5.5
Rwanda	1,015	18.6	6
Sierra Leone	600	4.2	3.7
Somalia	440	8.1	2.5
South Sudan	310	4.4	5.2
Sudan	800	35.2	1.0
Syrian Arab Republic	640	12.8	2.1
Togo	1,020	8.6	5.1
Uganda	880	48	5.7
Yemen, Rep.	760	27.1	3.0

Table2 – list of lower middle income countries

Country/Economy	GNI per Capita (US\$)	GDP (US\$ billions)	Real GDP Growth (%)
Angola	3,100	89.5	2.3
Bangladesh	2,700	479	6.1
Bhutan	3,800	3.5	5
Bolivia	3,600	47.3	4.3
Cabo Verde	3,600	2.7	4

Cambodia	1,620	33.2	5.5
Cameroon	1,490	45.8	3.1
Comoros	1,350	1.2	3.2
Congo, Rep.	2,010	11.8	3.6
Djibouti	3,260	3.5	5.8
Egypt, Arab Rep.	4,050	404	4.4
Eswatini	4,280	5.4	2.8
Ghana	2,300	94.4	4.2
Guatemala	4,340	97.5	3.3
Honduras	2,800	31.7	3.5
India	2,650	3,734.00	6.5
Indonesia	4,340	1,274.00	5.1
Jordan	4,360	48.3	2.5
Kenya	2,050	117.8	5.9
Kiribati	2,190	0.25	1.0
Kyrgyz Republic	1,260	9	3
Lao PDR	2,620	20.2	6.7
Lebanon	4,480	21.2	10.0
Lesotho	1,310	3	2.1
Mauritania	4,490	11.5	3.7
Micronesia, Fed. Sts.	4,100	0.5	1.2
Morocco	4,240	144	3
Myanmar	2,290	78.1	1
Namibia	4,350	13	2
Nepal	1,460	47.3	4.9
Nicaragua	2,200	15.7	4.1
Nigeria	2,450	552	2.9
Pakistan	1,610	377	3
Papua New Guinea	3,030	31.5	3.8
Philippines	3,900	449	5.2
Senegal	1,550	26.9	6.4
Solomon Islands	2,100	1.4	2.1
Sri Lanka	4,260	77	2.5
Tajikistan	1,230	9.6	7
Tanzania	1,050	76.9	5.5
Timor-Leste	1,380	2.1	4.5
Tunisia	4,200	49.9	2.3
Uzbekistan	2,230	75	4
Vanuatu	3,200	1	3.2

Viet Nam	3,200	1,085.00	6
West Bank and Gaza	4,380	18.5	3
Zambia	3,250	27.2	4
Zimbabwe	1,430	25.3	2.6

Table 3list of Upper middle income countries

Country/Economy	GNI per Capita (US\$)	GDP (US\$ billions)	Real GDP Growth (%)
Albania	5,200	18.4	3.5
Algeria	4,950	193	3
Argentina	10,720	1,898.00	2.5
Armenia	4,780	14.5	5
Azerbaijan	4,960	52	0.5
Belarus	6,430	67.3	1.8
Belize	6,230	2	2
Bosnia and Herzegovina	5,400	22.2	3
Botswana	7,860	19.5	4.5
Brazil	8,820	1,898.00	2.5
Bulgaria	10,820	84.3	1
China	13,120	19,374.00	4.8
Colombia	7,080	345	2.2
Costa Rica	8,110	85.9	3
Cuba	11,200	110	0.5
Dominica	9,070	0.6	2.5
Dominican Republic	9,180	148	5
Ecuador	6,050	111	1.5
El Salvador	4,620	34.6	2.8
Equatorial Guinea	10,340	13.3	1
Fiji	5,650	5.6	3.2
Gabon	8,700	18.4	1
Georgia	5,060	20.5	4
Grenada	7,250	1.3	3
Guatemala	4,350	97.5	3.3
Guyana	4,980	12.5	6
Iran, Islamic Rep.	5,550	306	1
Iraq	4,990	289	6.7
Jamaica	5,480	15.2	1.8
Kazakhstan	9,250	244	3.4
Kosovo	5,180	9	3.5
Libya	6,550	75.3	3.5

Malaysia	12,050	411	4.7
Maldives	6,750	7.6	4.1
Marshall Islands	5,120	0.2	0.8
Mauritius	10,720	14	3
Mexico	10,080	1,425.00	2.1
Mongolia	4,830	15.1	1.4
Montenegro	8,100	5.7	2.7
North Macedonia	6,100	13.2	2.8
Paraguay	5,180	40.5	3.5
Peru	7,020	253	2.4
Romania	11,890	340	2.5
Russian Federation	11,260	2,430.00	1.8
Samoa	4,580	1	2
Serbia	7,300	75	3
Seychelles	12,190	1.7	3.2
South Africa	6,970	419	1.4
St. Lucia	7,640	2	2.7
St. Vincent and the Grenadines	7,180	0.9	3.2
Suriname	10,500	5.4	3
Thailand	7,200	530	2.5
Tonga	4,700	0.5	1.8
Tukiye	10,920	932	3.2
Turkmenistan	7,140	46.3	6
Tuvalu	4,540	0.04	0
Ukraine	4,780	202	2
Uruguay	12,350	74.5	3

Table 4- List of high income countries.

Country/Economy	GNI per Capita (US\$)	GDP (US\$ billions)	Real GDP Growth (%)
Andorra	49,500	3.2	1.2
Antigua and Barbuda	17,900	1.7	1.0
Aruba	25,400	3.3	1.5
Australia	72,600	1,873.00	2
Austria	53,800	482	1.2
Bahrain	27,800	44.4	2.5
Barbados	18,200	5	1.8
Belgium	51,300	564	1.1
Bermuda	1,11,030	8.6	0.5
Brunei Darussalam	33,200	13.4	3

Canada	59,700	2,256.00	1.8
Cayman Islands	62,300	4.3	2
Channel Islands	53,400	8	0.5
Chile	16,500	365	1
Croatia	17,800	74.5	1.5
Cyprus	24,300	24.9	2
Czechia	25,200	307	1.8
Denmark	64,200	432	1
Estonia	30,500	36.9	1.5
Faroe Islands	48,000	2.6	0.8
Finland	51,600	298	1
France	45,100	3,060.00	1.3
French Polynesia	17,900	6.2	0.5
Germany	48,428	4,031.00	1.1
Gibraltar	54,500	2	0
Greece	23,600	238	1.4
Greenland	55,200	2.9	0.6
Guam	35,600	6.7	0.2
Hong Kong SAR, China	53,600	368	3
Hungary	19,400	189	1.3
Iceland	82,400	27.8	2
Ireland	84,500	577	2.5
Isle of Man	46,200	6.4	0.7
Israel	48,700	565	3
Italy	36,200	2,101.00	0.4
Japan	35,149	4,460.00	1.2
Korea, Rep.	36,400	2,038.00	2.1
Kuwait	32,900	115	0.8
Latvia	20,300	41.8	2.2
Liechtenstein	1,65,000	6.2	1.5
Lithuania	23,100	67	1.9
Luxembourg	1,39,500	85.3	3.5
Macao SAR, China	90,300	29.4	5
Malta	31,500	17.1	2
Monaco	1,90,000	7.2	1.4
Netherlands	58,200	1,015.00	1.6
New Caledonia	32,400	11.8	0.9
New Zealand	48,200	244	2.1
Northern Mariana Islands	33,200	1.3	0.5

Norway	87,500	525	1
Oman	22,200	99	1.4
Panama	19,400	77.6	3.1
Poland	18,900	735	1.7
Portugal	24,800	248	1.6
Puerto Rico	32,800	124	1
Qatar	62,800	204	2
San Marino	52,400	2.1	0.5
Saudi Arabia	25,600	1,105.00	2
Singapore	73,900	546	2.5
Slovak Republic	22,300	129	1.5
Slovenia	28,900	65.8	2.3
Spain	33,200	1,425.00	1.8
St. Kitts and Nevis	17,200	1	1.0
St. Martin (French part)	19,800	0.5	0
Sweden	58,000	630	1.1
Switzerland	86,400	824	1.4
Taiwan, China	32,800	831	2.5
Trinidad and Tobago	19,200	27.1	0
United Arab Emirates	43,100	501	3
United Kingdom	49,700	3,354.00	1.5
United States	80,035	26,854.00	2.3
Uruguay	12,350	74.5	3
Virgin Islands (U.S.)	33,900	2.3	1

Secondary data on carbon taxes, individual income taxes, greenhouse gas (GHG) emissions, and related variables were obtained from authoritative government and institutional sources. National data include annual reports and statistical releases from the Ministry of Petroleum and Natural Gas, the Ministry of Environment, Forest and Climate Change (MoEFCC), the Central Pollution Control Board (CPCB) of India, and the Ministry of Earth Sciences. International datasets were drawn from the Intergovernmental Panel on Climate Change (IPCC), the Organisation for Economic Co-operation and Development (OECD), and the European Union (EU), supplemented by analyses and publications from independent research and investigative agencies.

Analysis and Interpretation: Environmental Taxation as a Fiscal Measure for Negative Eco Externalities

This section examines the effectiveness of environmental taxation in reducing negative social externalities, with greenhouse gas (GHG) emissions serving as the primary indicator. To quantify this relationship, total environmental taxation—comprising energy taxes, pollution taxes, resource taxes, and transportation taxes implemented across various European countries—is included as a key independent variable. Additional covariates comprise GDP per capita, renewable energy consumption, urban population share, energy intensity, and degree of industrialization. The dependent variable is total GHG emissions. Panel data for the period 2000–2022 are drawn from the OECD and World Bank databases.

As environmental pressures intensify, governments must reconcile ecological protection with economic growth. Environmental taxation offers a mechanism to internalise the social costs of pollution by levying charges on environmentally harmful activities. Precisely quantifying these social cost externalities is essential to define the tax base, set optimal tax rates, and design an effective environmental tax framework for India. Such a model integrates environmental costs into production pricing, enhancing fiscal efficiency and promoting sustainable development. Evaluating the feasibility of implementing this framework through direct or indirect tax channels is critical for mitigating externalities within India's corporate sector and broader economy.

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